Headquarters U.S. Air Force

Integrity - Service - Excellence

Air Force Privatization Program Economics

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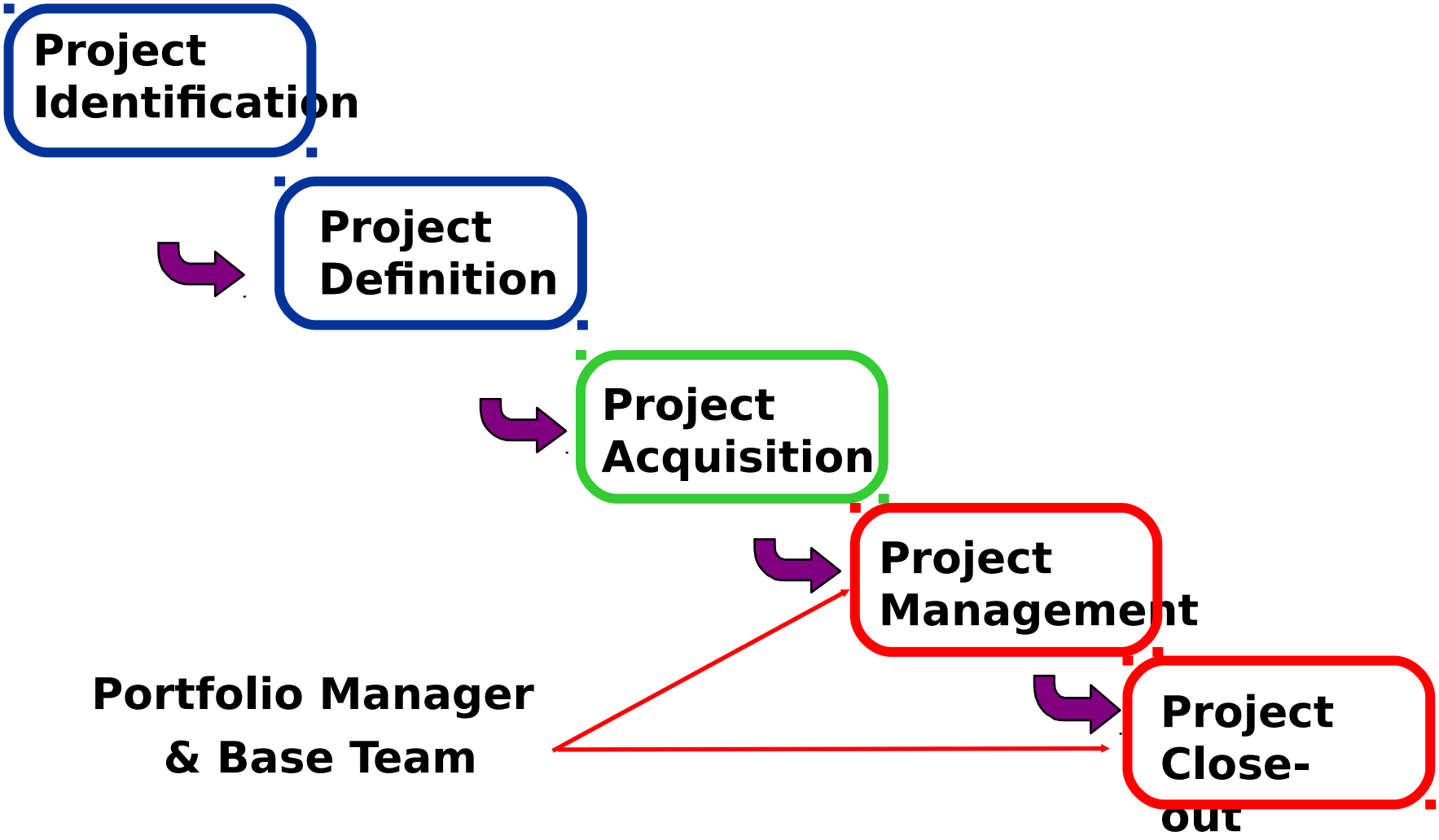
Housing Privatization Process



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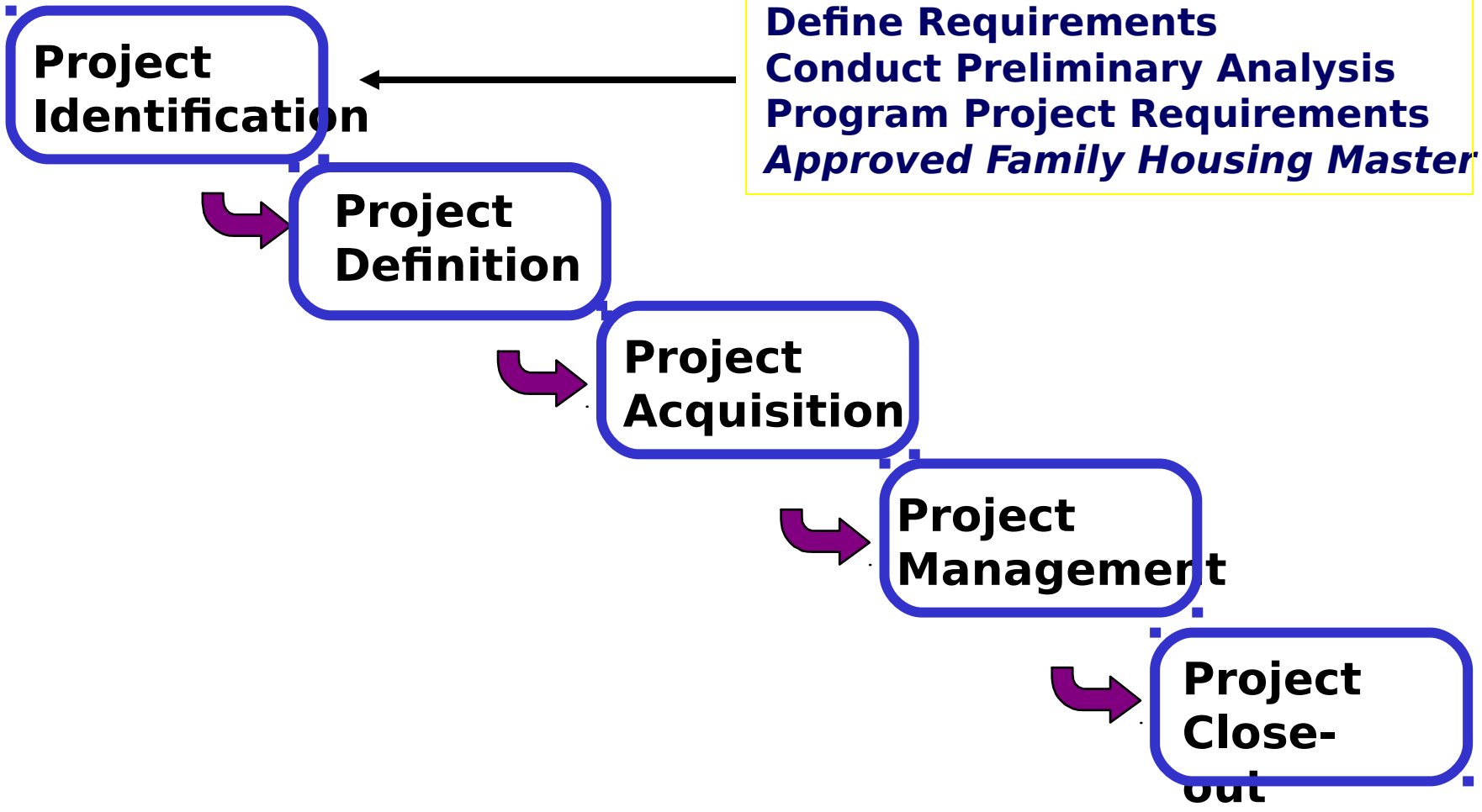
Project Identification



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Project Definition

Project Identification

Project Definition

Project Acquisition

Project Management

Project Close-out

Evaluate Use of Authorities
Initiate Preliminary Studies/Analysis
- **Pro-forma Feasibility**
- **Economic Analysis/Lifecycle Cost**
- **Environmental Baseline Surveys**
- **Land Surveys and Appraisals**

Develop Acquisition Documents
Review and Approve Concept
Congressional Notification to Advertise

Project Definition

- Site Orientation Visit
  - Introduction of Project Development Team (PDT)
  - Review of FHMP and HRMA to identify baseline project scope
  - Study the local housing market, development costs and economic development activities
  - Develop a preliminary pro-forma based on FHMP and input from the Base
  - Evaluation use of the authorities based upon defined project scope

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Project Definition

- Post Site Orientation Visit
  - Develop Draft Concept Pro-forma
    - Refine financial pro-forma analysis
      - Base input and analysis of base information
      - Local market data
      - National lending requirements
  - Preliminary Economic Analysis
    - SAF/FMC - 20 August 1999 Guidance
      - Compares six alternative execution methods:
        - Privatization, Status Quo, Identical MILCON, Constrained MILCON; Current BAH and Full BAH
    - OSD Lifecycle Policy Memo - February 2002
      - Compares Privatization to Identical MILCON

Project Definition

- PDT #1
  - Present Draft Concept Pro-forma and Preliminary EA Results
    - Refine financial pro-forma analysis
    - Refine EA analysis
  - Review generic RFP documents
    - Review RFP and Legal Documents
    - Begin to populate RFP Documents with Base Specifics
    - Develop data calls and taskers for PDT members for necessary RFP information

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Project Definition

- PDT #2
  - Present Preliminary Draft RFP
    - Continue to populate RFP
    - Review RFP for changes/additions
- Develop Concept Approval Documents
  - Finalize Concept pro-forma
  - Finalize Preliminary Economic Analysis
  - Complete Preliminary Scoring Report
  - Develop Concept Brief

Project Definition

- PDT #3
  - Finalize Draft RFP
- Concept Approval
  - Approval of Financial Documents and EA Report from MAJCOM and SAF FM
  - Air Force Briefing and Approval of Concept
  - OSD Concept Briefing and Approval of Concept
  - Congressional Notification

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Project Definition

- Industry Forum
  - Issue preliminary draft RFP or statement of need
  - Hold industry forum to present project to potential bidders and interested parties in advance of RFP issuance
    - Overview of program
    - Define of Scope of Work
    - Tour Housing Area
    - Q & A Session to get industry feedback
- Finalize RFP
  - Air Force staffing and approval of RFP

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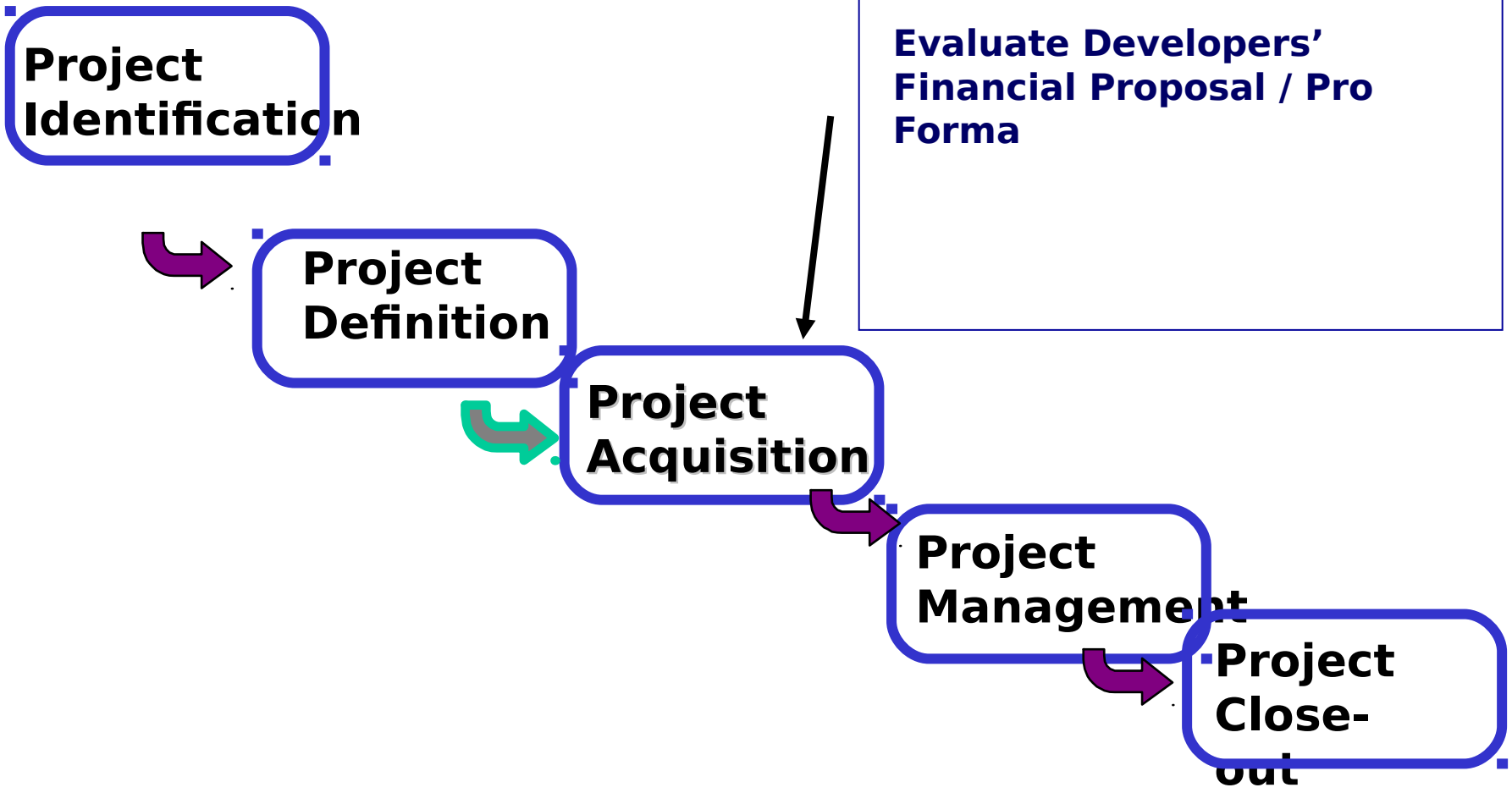
Project Acquisition



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Project Acquisition

- **Evaluate Developers' Financial Proposals (Pro Forma)**
  - Most important Volume/Factor in the proposal
- **Evaluate Financing Plan**
  - Financing/Lender Contingencies
  - All-in financing costs (interest rates, points, credit enhancement fees, etc.)
  - Debt-Service coverage requirement
  - Interest rate protection plan
  - Scored costs of proposed Gov't guaranteed or direct loans
- **Evaluate Development Costs & Fees**
  - Construction Fees relative to market/industry benchmarks
  - Reasonableness of development fees
  - New construction costs per square foot compared to current local market experience
  - Renovation costs per square foot compared to current local market experience

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Project Acquisition

- **Evaluate Revenue Projects**
  - Appropriate calculation of rental income (BAH less utility allowance)
  - Compliance with required service member demographics
  - Reasonableness of vacancy and credit loss allowance
- **Evaluate Operating Expense Projections Compared to Local Market Experience**
  - O&M Expenses per unit or square foot experience
  - Property management & other incentive fees
  - Evaluate reasonableness of utility expenses
  - Review property tax assumptions
- **Evaluate Replacement Reserves Compared to Industry Standards**
- **Evaluate of Developers' Return Requirements**
- **Evaluate Contributions to the Reinvestment Account**
- **Evaluate Net Cash Flow to Developer vs. the Project**

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Initial and Final Pro Formas

- **Difference between Initial and Final Pro Forma**
  - Initial pro-forma (Government Developed Estimate)
    - Designed to test feasibility
    - Helps layout project scope and timing
    - Determines the potential need for government subsidy
    - Drives the development of the RFP
    - Not used by PSC in evaluating bidder's financial proposals
  - Final pro-forma (Individual Bidder Proposed Financials)
    - Bidder's pro-formas will vary in form and content
    - Bidder's pro-formas tested against RFP requirements

Source Selection

- **Source Selection – Relationship between EA and Pro forma**
  - Preliminary EA at Concept Development Stage
  - Final EA based upon Pro Forma after Selection (deal terms)
    - Privatization
      - Update BAH rates
      - Scoring for Developer Proposal
    - MILCON
      - Update BAH rates and timing for Drayage
      - Reflect proposed Construction Costs (MILCON-equivalent)
      - Reflect proposed Construction Schedule

Financial Feasibility

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Financial Feasibility

- **A/F financial criteria:**
  - **Must get at least $3 construction for each $1 AF cost**
  - **Life cycle cost must favor privatization over MILCON**
  - **Privatization must be within financial participation limits**
    - Minimum developer equity investment - 5%
    - Maximum government participation - 80%
    - Maximum government loan - <50% of total loans
- **Private Sector financial criteria:**
  - **Internal Rate of Return (IRR) commensurate with Project Risk**
  - **Stability of Cash flow to meet lender Debt Service Coverage (DSC) Requirements**
  - **Reasonable Equity requirements**

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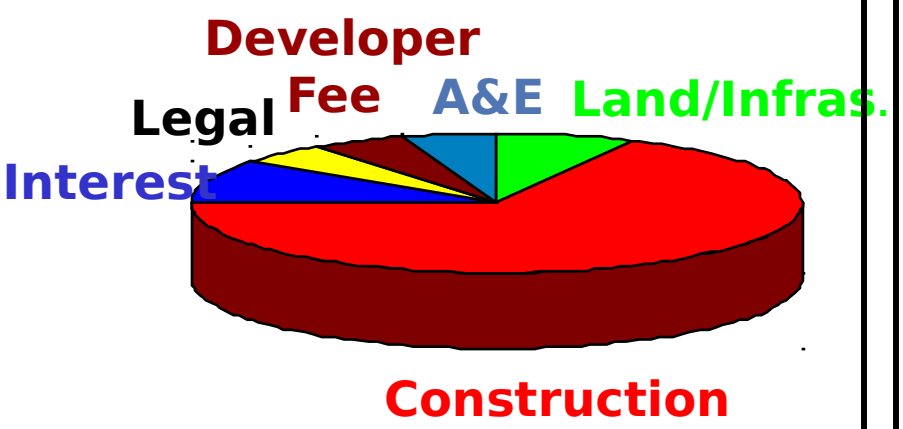
Financial Gap

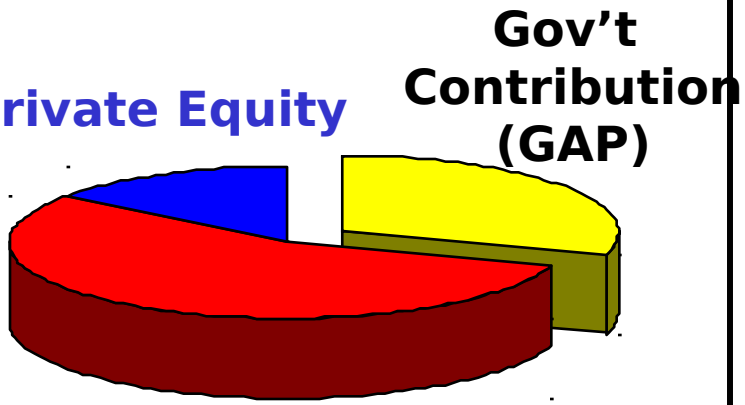
- **A financial gap occurs when the income stream provided by the military members rent (BAH less utility allowance) is insufficient to support a private sector mortgage level commensurate with the funding requirements to meet the project scope.**
- **Government authorities are used to help fill the gap**
  - Conveyance
  - Limited Guarantee
  - Direct Loan

Understanding Privatization Economics

DEVELOPMENT COSTS



FINANCING



OPERATIONS

GROSS INCOME - OPERATING EXPENSES = NET OPERATING INCOME - DEBT SERVICE → NET CASH FLOW

Case Study – Robins AFB – 370 New / 300 Rehab Units

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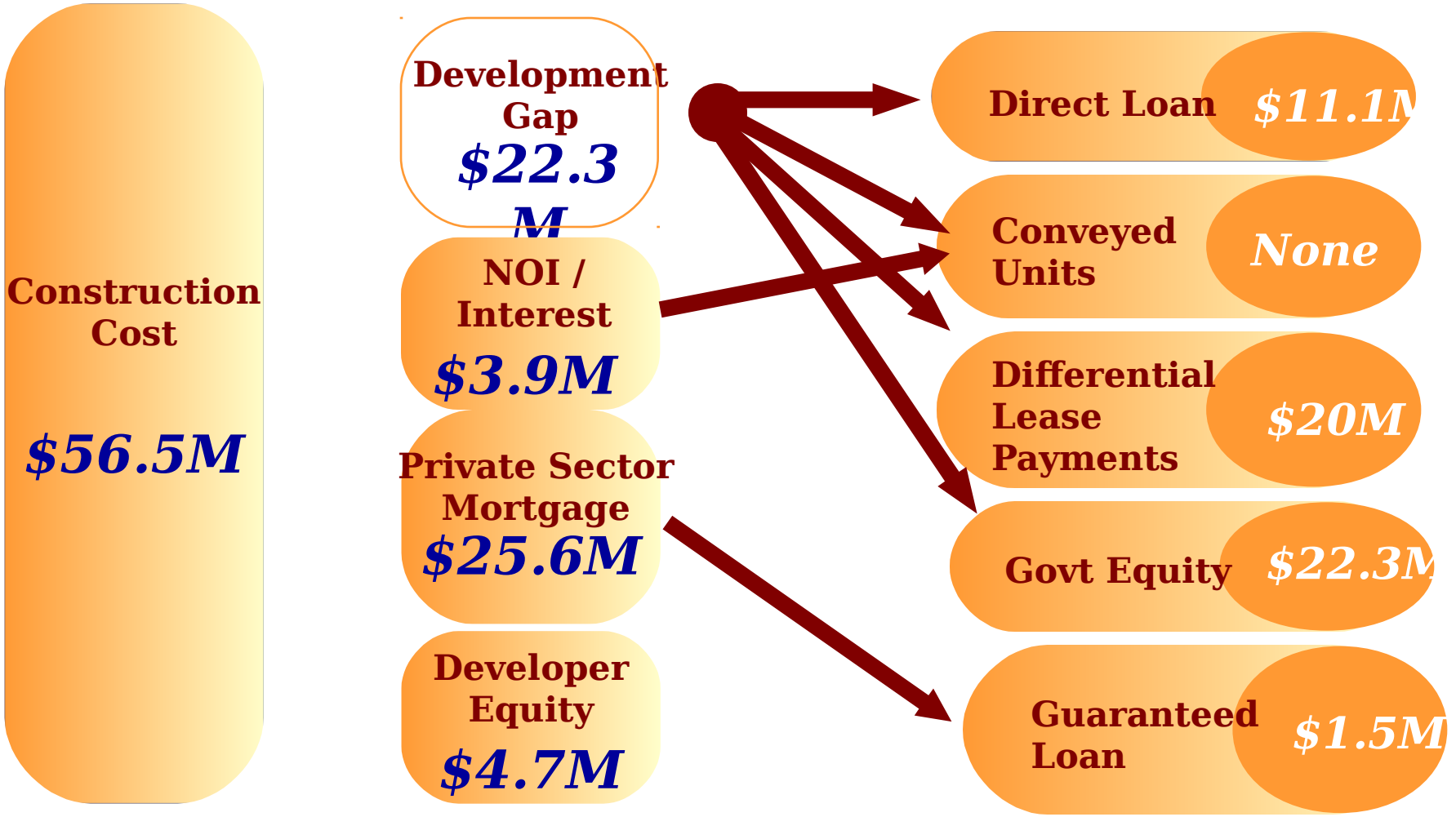
Authority | Appropriatio



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Case Study – Robins AFB – 370 New / 300 Rehab Units

Summary Schedule of Budget Scoring				
Authority	**Authority Section**	**Loan Amount (Millions)**	**Est. Scoring Amount (Millions)**	**Est. Subsidy Rate**
Land Lease	2878	-	-	-
Create Mandatory Allotments for Rent	2882	-	-	-
Partial Loan Guarantee	2873	$25.6	$1.5	6.00%
2nd Mortgage	2873	$22.3	$11.1	49.70%
Total Scoring		**$47.9**	**$12.6**	

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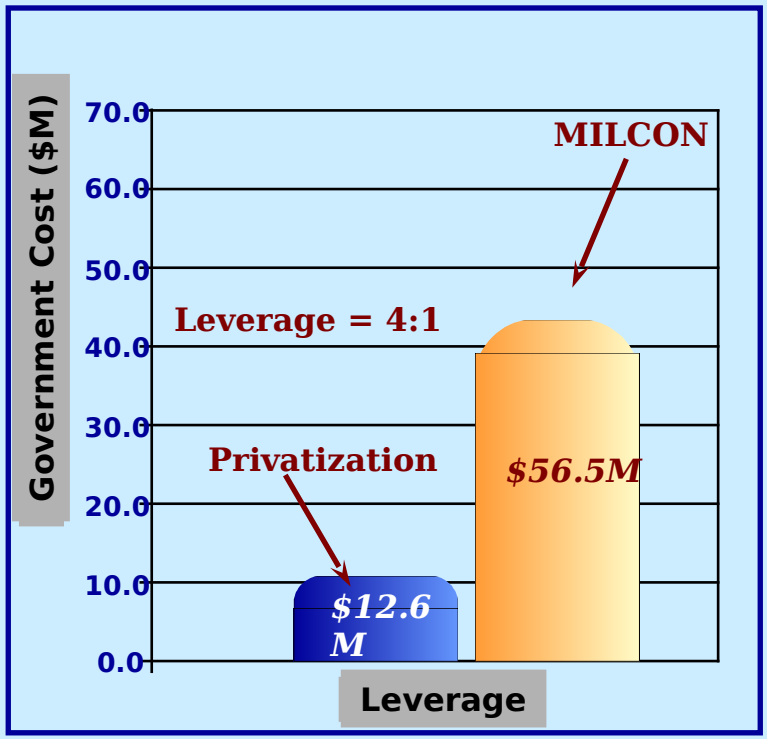
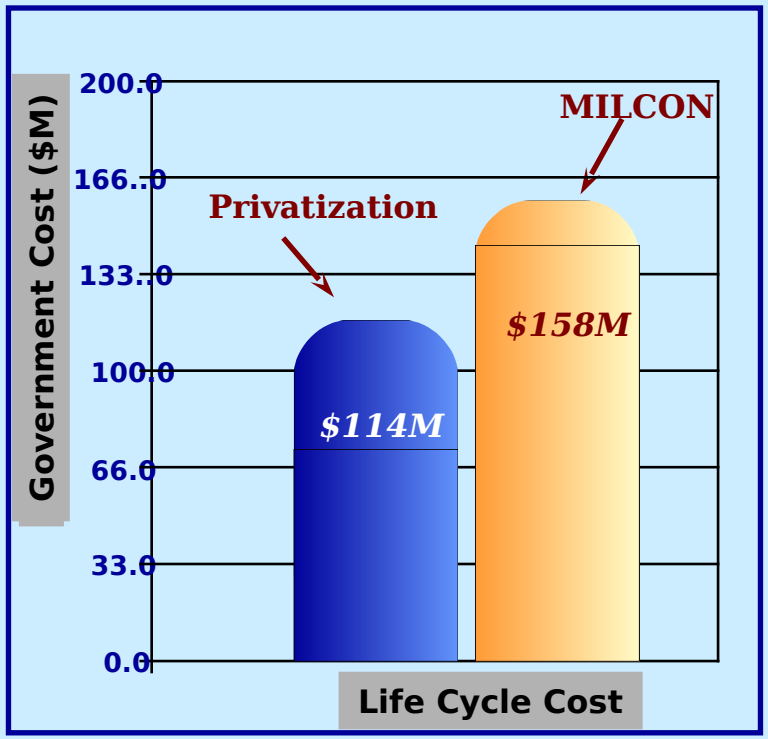
Case Study – Robins AFB – 370 New / 300 Rehab Units

Leverage and Life Cycle Cost





Financial Feasibility
Pro Forma Model

Model History

- **Brief History of Model Evolution**
  - Kaiser Model 1996 (Excel)
  - HRSO Model 1997- 2002 (Excel 95)
  - AF Housing Model 2002 (Single-user executable program)

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Model History

- **Objectives of the New AF Housing Model**
  - Incorporate lessons learned from past deals
  - Real-world financing and underwriting methodology
  - User-friendly

- **Characteristics of the New Model**
  - Machine language
  - User Manual
  - Accessible via the Internet
    - Download Instructions
    - Website Address
      http://12.20.225.17//housingmodel/download.asp

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Model Overview

- **At its core, the model operates similar to its predecessor**
- **Calculates the development costs, available market financing, and anticipated cash flow for proposed military housing projects based on the following inputs:**
  - Number and type of units
  - BAH rates and unit demographics
  - Timing of demolition/renovation/construction
  - Demolition/renovation/construction costs
  - Vacancy and Expenses
  - Financing Options related to construction and management of the proposed development

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Model Overview

- **Based on the inputs, the model provides:**
  - Forecasts cash flow over a 50-year period with a ten-year development period
  - Allows the user to test the effects of different authorities available for closing the development gap
  - Calculates the federal budget scoring impact of the authorities
  - Calculates the participation levels for the Government and private sector
  - Provides an indication of project feasibility

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New Features/Enhancements

- **The Model has been enhanced to improve accuracy and incorporate lessons learned:**
  - Preferred Returns (PR) with two options available
    - PR for all 50 years with a return of equity in year 50
    - Payout of accrued preferred return from development period and return of equity when funds available).
  - Two IRR Calculations – Equity only and Equity with Fees
  - More accurate reflection of market debt structures
  - Allows two-tiered direct loan interest rate
  - Modeling of the Re-investment account
  - True out-year renovation abilities with out-year re-debting

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New Features/Enhancements

- **The Model has been enhanced to improve accuracy and incorporate lessons learned (continued):**
  - Breakout of construction profit and development profit
  - Detailed Operations & Maintenance categories
  - Improved accuracy of income stream through demolition assignment schedule
  - Unlimited unit type entries
  - Other costs tab for non-income generating costs, including any escrow accounts

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Backup Slides

AF HOUSING MODEL REVIEW

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Model Review
Base Perspective – "RFP"

- **Scenario Description (Cover Page)**
  - **Demolition**
  - **Renovation**
  - **New construction**
  - **Amenities**
  - **More descriptive the better**
- **Conveyed Units Property (Page 5)**
  - **Existing unit distribution by housing area and bedroom**
  - **Estimation of economic life remaining**

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Model Review
Base Perspective – "RFP"

- **Timeline Schedules – Demolished, Renovated, Constructed units (pages 6-8)**
  - **Number of units**
  - **Cost/unit or sf (completed projects, local market survey)**
  - **Timing or phasing (is it reasonable?)**
- **Timeline Schedule – Other costs**
  - **Amenities (pools, community centers, etc.)**
  - **Additional Infrastructure Improvements**
  - **Utility upgrades, etc.**

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Model Review
Base Perspective – "RFP"

- **Construction Cost Schedule (page 10)**
  - **New unit square footages (consistent w/AF programmatic guidelines)**
  - **Construction cost/unit or sf**
- **Renovation Cost Schedule (page 11)**
  - **Total cost/unit**
- **Outyear Renovation and Construction**
  - **Start and end dates**
  - **Percentage of total units**
  - **Construction time/unit**
  - **Total cost/unit**

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Model Review
Base Perspective – "RFP"

- **Personnel Schedules – Existing, Demolished, Renovated, Constructed (pages 13-16)**
  - **BAH rates (check against current year)**
  - **Estimated utility allowances**
  - **Unit distribution by rank and housing area**
    - **Consistent with HMA demographics**
    - **Housing Office input**

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Model Review PSC Perspective – "Developer"

- **Inflators, Operating Inputs (Page 3)**
  - **Lessons Learned**
    - **Annual inflators (typically 3%)**
    - **Capitalization rate**
    - **Cost year (current year)**
    - **Tax calculation/Tax rate (market specific)**
    - **Average vacancy (% of total units)**
    - **Reserve accounts interest rates**
    - **Interest on unused first mortgage proceeds**

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Model Review PSC Perspective – "Developer"

- **Loan Information (page 4)**
  - **Construction loan**
  - **First mortgage**
    - **Market interest rates and terms**
  - **Second mortgage**
    - **Project determined flexible interest rates**
    - **Up to 10-year interest only period, 40 year total term**
    - **Two-tiered rate will reduce Scored Cost**
  - **Equity (5% of construction cost)**
- **All Unit Input Forms (page 5-16)**
  - **Check input data against information collected from Base**
  - **Cross-check timeline schedules against personnel schedules**

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Model Review PSC Perspective – "Developer"

- **Income/Expense Schedules (pages 17-19)**
  - **Rent Amount**
  - **Utilities**
  - **Insurance**
  - **Property management**
  - **Operations & maintenance**
  - **Other**
  - **Taxes**
  - **Replacement reserves**
  - **Check for Reasonableness**

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Model Review PSC Perspective – "Developer"

- **Revenue and Expense by Construction Type (pages 20-25)**
  - **Check changes in net operating income for existing, renovated, constructed units**
  - **Validate against timeline schedules**
- **Cashflow Schedule**
  - **Check flow of funds for consistency**
  - **Timing of financing**
  - **Combined debt service coverage (> 1.05) in year of Govt Loan Funding and upon commencement of loan amortization**

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Model Review PSC Perspective – "Developer"

- **Sources and Uses Schedule (pages 32-37)**
  - **Check Loan Balances for proper amortization inputs**
    - **Loan Beginning Dates**
    - **Loan Ending Dates**
- **Scoring (page 38)**
  - **Check first and second mortgage subsidies**
  - **Always "recalc" after making input changes**